This record is a partial extract of the original cable. The full text of the original cable is not available.

UNCLAS SECTION 01 OF 02 PRETORIA 003681

SIPDIS

SENSITIVE BUT UNCLASSIFIED

E.O. 12958: N/A
TAGS: ECON EFIN SF
SUBJECT: SOUTH AFRICA: SARB LOWERS INTEREST RATES

SENSITIVE BUT UNCLASSIFIED, PROTECT ACCORDINGLY.

Summary

¶1. (U) Tito Mboweni, Governor of the South African Reserve Bank (SARB), announced a 0.5 percent decrease in the bank's repurchase rate on August 12. The decision, taken by the Monetary Policy Committee, served to lower the repurchase rate to 7.5 percent, the lowest since the inception of a fixed repurchase rate in September 2001. The decision caught most economic analysts by surprise, but may have been influenced by widespread opinion that the rand is too strong and a union march on the SARB the previous day. The repurchase rate is the rate at which the SARB lends to local banks. End Summary.

Unions and Industry Wanted the Cut

¶2. (U) The decision by the Monetary Policy Committee came a day after union workers marched on the SARB to protest the effect of a strong rand on industry, particularly on gold mining, which has experienced thousands of layoffs in recent months. In his statement, Mboweni acknowledged that the strong rand was seriously hurting mining and manufacturing in South Africa and distorting business planning. He noted that South Africa's international trade balance had fallen from a R30 billion surplus in the second quarter of 2003 to a deficit of R5.5 billion in second quarter of 2004.

Markets React to Interest Rate Movements

¶3. (U) Just two days earlier, the Federal Reserve had raised U.S. interest rates a quarter point for the second time in 45 days. The two actions served to close the interest rate differential between the two economies and reduce the incentive to portfolio investors to invest in rand based assets. Foreign exchange markets reacted immediately, as the rand fell 3 percent in value to 6.5/dollar in next day trading. Capital markets also saw a burst of activity surrounding South African gold mining stocks, many of which jumped several percentage points.

Mboweni Focuses on Positive Outlook for Inflation

¶4. (U) In his public statement, Mboweni chose to focus mostly on the positive outlook for inflation. He noted that producer price inflation remained low, though no longer in the negative category, and that import price inflation had remained negative due to the strengthening rand. While consumer prices were picking up, led by the cost of vehicles, healthcare, alcohol, tobacco, fuel, and certain administered prices, food prices were recovering from last year's drought and the government was likely to exercise greater restraint on administered prices (e.g., electricity and water) in future. Continued fiscal prudence, low capacity utilization, and the declining trend in inflation expectations translated into an overall positive outlook for inflation. In the second quarter of 2004, annualized CPIX (consumer inflation less mortgage costs) was 5.2 percent.

Comment

¶5. (SBU) Mboweni was reappointed by President Mbeki to another five-year term as SARB Governor on July 23, after consultations with Finance Minister Trevor Manuel who was rumored to favor a cut in interest rates. With the unions marching the previous day and widespread public opinion in support of lower interest rates, one wonders what role political pressure played this time around in the decision of the Monetary Policy Committee. Indeed, Mboweni could have just as easily focused on threats to inflation, including rising wage costs and record oil prices, in his statement to support leaving the repurchase rate unchanged. The Federal Reserve had finally begun to raise U.S. interest rates, and this would slowly impact the dollar value of the rand. Moreover, CPIX in the first quarter of 2004 was 7.2 percent, above the SARB's annual target range of 3-6 percent.

¶6. (SBU) If political pressure did play a role, then union

pressure may have been the deciding factor. On August 11, the day before the Monetary Policy Committee's decision, Mboweni met with members of the National Union of Mineworkers and the Congress of South African Trade Unions (COSATU) after thousands marched on the SARB to protest the strong value of the rand. Chamber of Mines representatives dotted the march. Despite this protest, most economic analysts believed that the Mboweni and his Monetary Policy Committee would stay true to their inflation fighting policies and leave the repurchase rate unchanged. This seemed affirmed by Mboweni's promise to give the unions a detailed response in fourteen days, well after the Monetary Policy Committee's decision the following day. If actions speak louder than words, then the decision to lower interest rates may obviate the need for Mboweni to provide much detail in his promised response. The unions got what they wanted. We note that prior to his appointment as SARB Governor in 1998, Mboweni served as Minister of Labor in Nelson Mandela's Cabinet.

FRAZER